fatPROPHETS™ 1300 881 177

U and I 15/03/2018 **FAT-UK-725**

UAI GBP £1.950 Special **HIGH** S

Knowing When to Fold Em

For the past couple of weeks, Members following our reports would know that we have been making an orderly exit from the UK property market with our previous reports on Travis Perkins, Bovis Homes, Barratt Developments and even Rightmove. The decision to leave the property sector is proving to be the right call as many of the picks have started to trend down amid bearish news. With that said, we move on to another property stock we are recommending exiting: **the U and I Group (LSE: UAI)**.

To recap, in our previous coverage of the company back in October 2017 (FAT-UK-706), we provided an update and our views on the First Half 2018 (1H18) results from the company.

The company showed a disappointing performance, reporting another quarterly loss, missing guidance targets and delivering only £7.2 million in development and trading gains against a target between £65 - £70 million. That was also a weak comparison to the previous year's performance.

HY 2018 PERFORMANCE	H1 2018	H1 2017	FY 2017
Development and trading gains	**£7.2m**	£11.5m	£35.0m
Basic NAV	**£336.8m**	£340.5m	£347.6m
Basic NAV per share	**269p**	272p	278p
Loss before tax	**(£3.3m)**	(£11.7m)	(£1.7m)
Basic loss per share	**(3.2p)**	(9.9p)	(2.4p)
Dividend per share (in respect of period reported)	**2.4p**	2.4p	5.9p
Supplemental dividend per share declared	-	-	2.8p
Net debt	**£159.4m**	£128.0m	£120.8m
Gearing	**47.3%**	37.6%	34.8%

Source: U and I Group

Admittedly, real estate development and trading can be unpredictable with projects possibly facing delays and tying up resources. This in turn leads to developers with tight cash flows (if any) and increasing use of leverage to make ends meet, which is particularly challenging when the cyclical real estate market shifts for the worst.

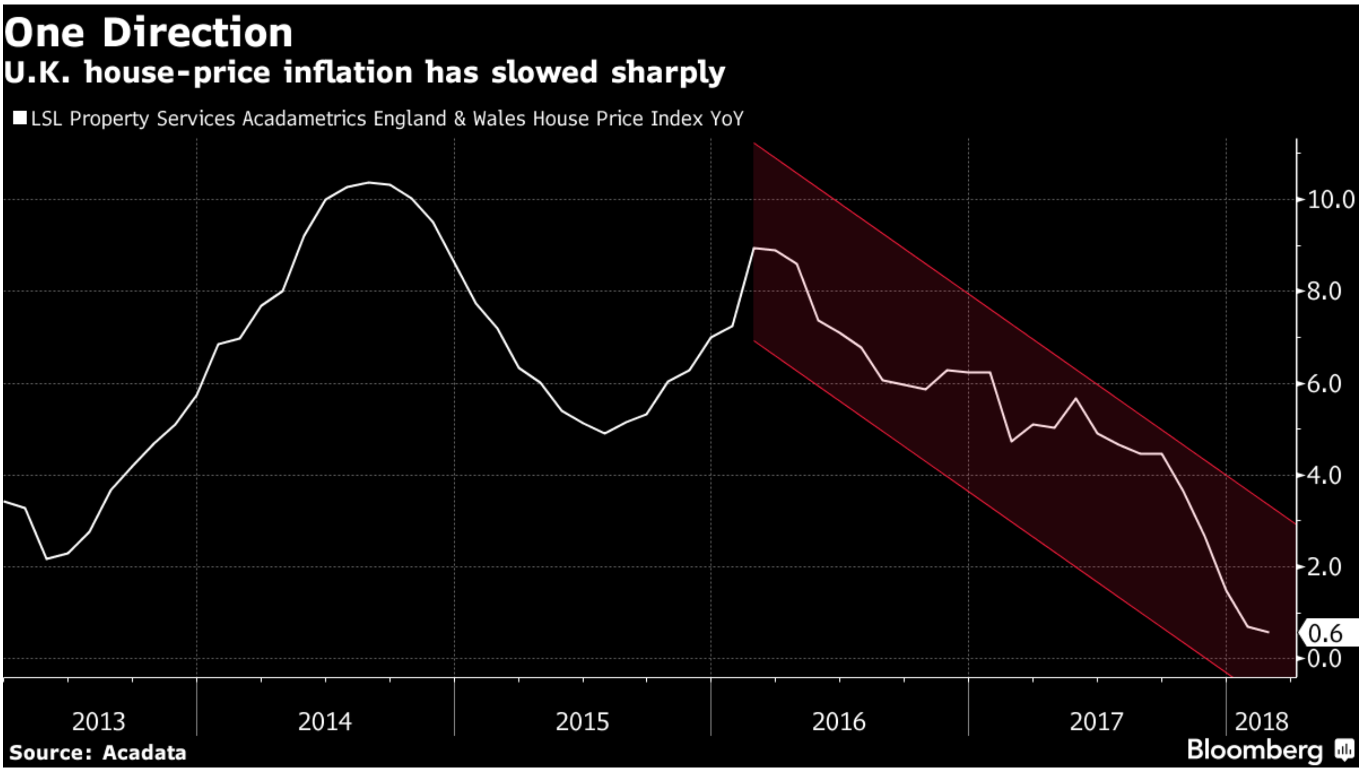
At the time of writing, we mused that the cyclical turnaround in the property sector was seemingly "delayed", but signs were actually pointing towards the end of the boom phase.

Previously, we rated the company a BUY given its substantial (~30%) discount to Net Asset Value (NAV) and a line-up of projects to be completed in the 2H18 that would allow the company to achieve its previously stated target of £65-£70 million.

That view proved to be correct given that management has disclosed a new trading update that the company is in fact set to achieve record development and trading gains for the fiscal year. CEO Matthew Weiner even chimed that “this has been an impressive year for U+I as we achieved record development and trading gains. This is just the beginning. We have the right team and strategy in place to continue to deliver sustainable year on year returns for our shareholders. I look forward to sharing positive news on the progress across our portfolio and our outlook for FY19 at the full year results.”

However, given the changes in the broader property sector and looming Brexit we believe it the right call to exit given the increasing risk in the property sector. The real estate is cyclical and was benefitting from the Bank of England’s (BoE) easy monetary policy and debt-fuelled spending across the world. However, we believe this to be an unsustainable source of growth.

As an update on the developments in the broader market, UK house price inflation continues to slump downwards as shown in the graphic below. According to Halifax, a subsidiary of the Lloyds Banking Group, price growth recently hit its lowest level for almost 5 years and marked the 9th consecutive month of the slowdown.



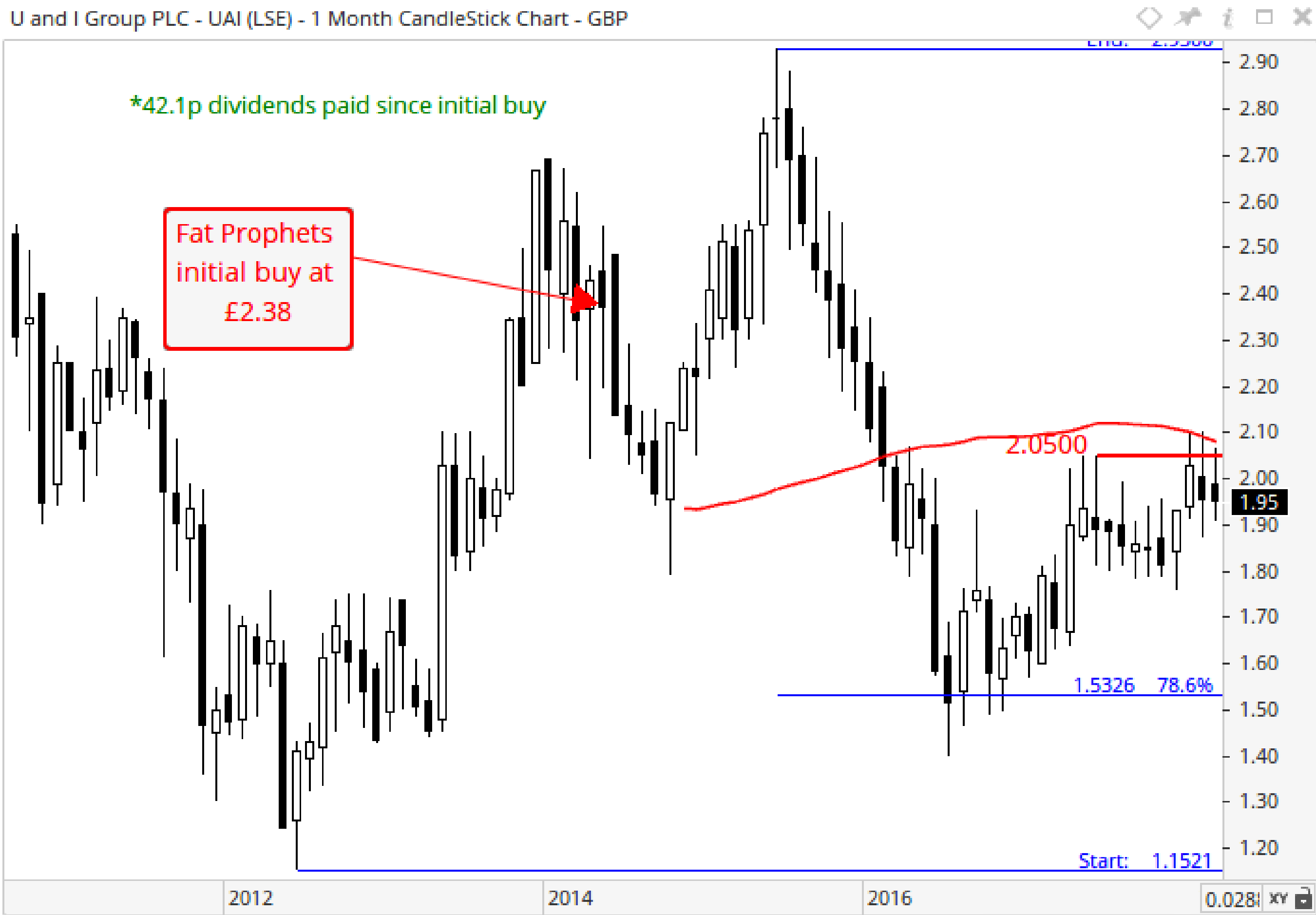
Source: Bloomberg

In light of that, the most affected market is London. On average, property prices in London fell 2.6% year-on-year to £593,396 in January, marking the largest drop since August 2009.

We believe that what happens in the London market will set the stage for the nation, as many real estate investors take their cue from the developments in the capital. This trend has also begun to spread to boroughs outside of London with South East of England and the Home counties reporting drops in volumes or prices.

This prevailing weakness may spread even further as falling prices can lead to a negative feedback loop where buyers hold back from fears of "catching a falling knife" and ending up with a mortgage loan higher than their equity. We already have seen some evidence of this as the Royal Institution of Chartered Surveyors disclosed results of a poll that new buyers have fallen for the 11th consecutive month in February.

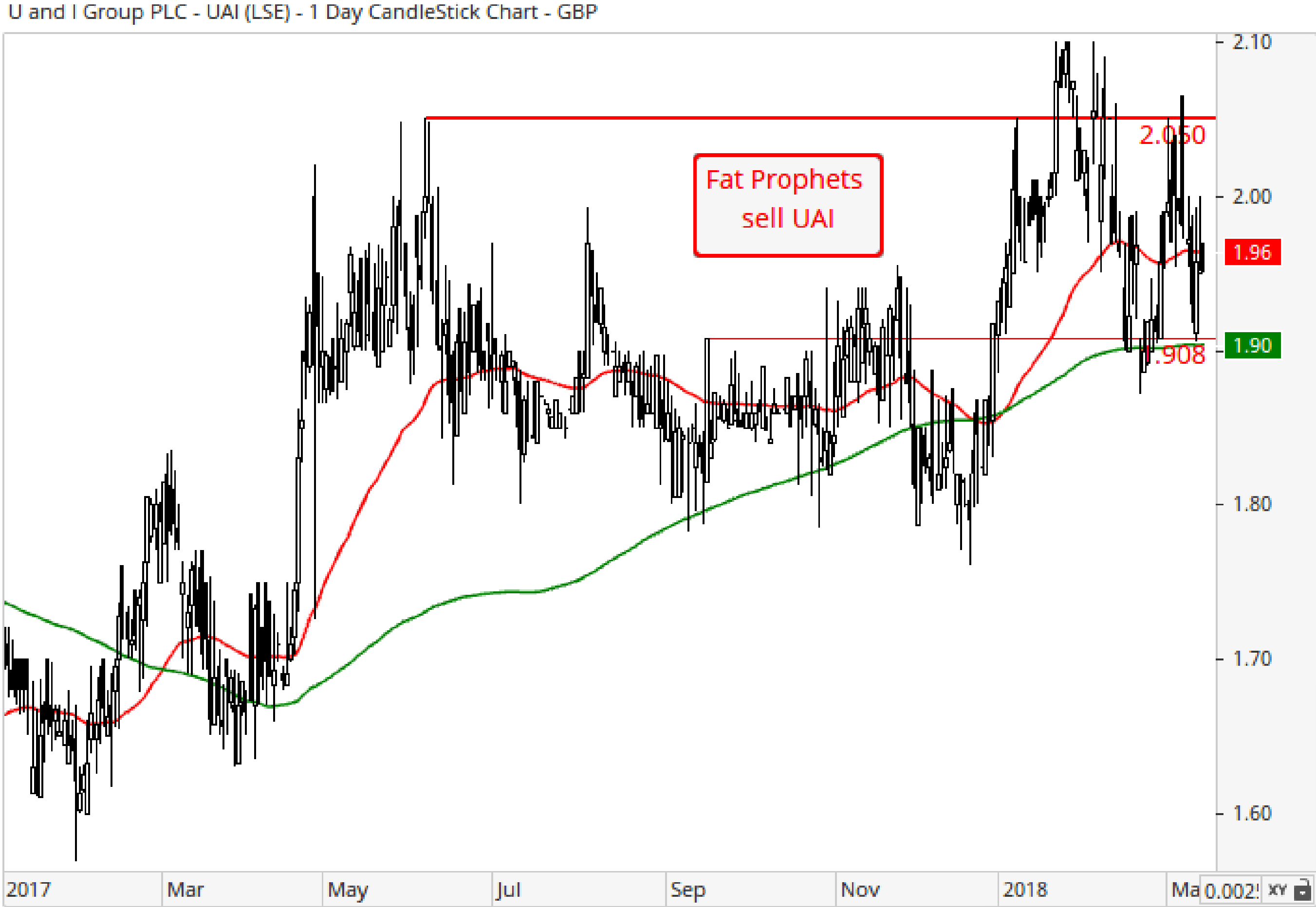
Another detractor to demand is the implementation of Section 24 of the Finance (no. 2) Act 2015 where landlords will no longer be able to deduct mortgage costs, leading to a tax bill for landlords. This will ultimately push investors out of the market as many will not want to be saddled with declining asset prices and low yields.



Summary

Despite the U&I group recently disclosing in a trading update that they are set to achieve their guidance for FY18, we believe that the risks in the broader real estate market are increasing.

Factors are signalling the end of the boom phase in the UK property market. This is evidenced by declining prices and transaction volumes, the tightening of lending, and the imminent BoE rate hike among other factors. Worse still is the fact that this may accelerate, with the looming Brexit which is expected to push away investors while pushing construction costs up.



Accordingly, we recommend to Members SELL their position in the U&I Group at current levels. It will be removed from the Fat Prophets portfolio.

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Snapshot UAI

U and I

Latest Closing Price: £1.95

U and I has a three-pronged strategy which includes an investment portfolio to provide income. Major development projects are undertaken with partners towards the end of the property cycle. Over the whole of the cycle the group is involved in regenerating undervalued or redundant real estate.

Market Capitalisation:£244.14M

	FY1	FY2
Price to Earnings	6.4	11.3
Dividend Yield (%)	9.2	6.1

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